INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	6
Conclusion	12
Appendix	13

CITATIONS

Cases:

- *Armstrong* v. *Commissioner*, 143 F. 2d 700 ... 10
- *Benson* v. *Commissioner*, 161 F. 2d 821 ... 8
- *Bradshaw* v. *Commissioner*, 150 F. 2d 918 ... 10
- *Commissioner* v. *Tower*, 327 U. S. 280 ... 6, 7, 8, 9, 11
- *Dawson* v. *Commissioner*, decided September 22, 1947 ... 8
- *Earp* v. *Jones*, 131 F. 2d 292, certiorari denied, 318 U. S. 764 ... 10
- *Eisenberg* v. *Commissioner*, 161 F. 2d 506, certiorari denied, October 13, 1947 ... 8
- *Grant* v. *Commissioner*, 150 F. 2d 915 ... 10
- *Hash* v. *Commissioner*, 152 F. 2d 722, certiorari denied, 328 U. S. 879, rehearing denied, 328 U. S. 838 ... 7, 11
- *Helvering* v. *Clifford*, 309 U. S. 331 ... 10
- *Losh* v. *Commissioner*, 145 F. 2d 456 ... 8, 10
- *Lusthaus* v. *Commissioner*, 327 U. S. 293 ... 6, 7, 8, 9, 11

Statutes:

- Internal Revenue Code:
  - Sec. 11 (26 U. S. C. 1940 ed., Sec. 11) ... 13
  - Sec. 22 (26 U. S. C. 1940 ed., Sec. 22) ... 13
  - Sec. 181 (26 U. S. C. 1940 ed., Sec. 181) ... 13
  - Sec. 182 (26 U. S. C. 1940 ed., Sec. 182) ... 13
  - Sec. 3797 (26 U. S. C. 1940 ed., Sec. 3797) ... 14

Miscellaneous:

- Treasury Regulations 103, Sec. 19.22(a)-1 ... 14

765662—47

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 377

WILLIAM A. BELCHER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 39–54) is reported at 7 T. C. 182. The opinion of the Circuit Court of Appeals (R. 127–130) is reported at 162 F. 2d 974.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 2, 1947. (R. 131.) The petition for a writ of certiorari was filed October 1, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's decision that business income attributed by taxpayer to his wife, individually and as trustee for their children, under a so-called partnership agreement, was includible in taxpayer's gross income as defined in Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra.*

STATEMENT

The pertinent facts found by the Tax Court (R. 40–54) may be summarized as follows:

From 1935 until the commencement of the taxable year (1941) taxpayer conducted a lumber manufacturing business as sole proprietor. On December 23, 1940, he executed a deed of gift transferring to his wife an undivided 34% interest in part of the physical assets of the business. On the same day he executed four identical deeds of trust transferring to his wife as trustee an 8% interest in the same assets for the benefit of each of his four children, who ranged in age from ten days to fourteen years. (R. 40–42.) On December 31, 1940, taxpayer entered into a "partnership agreement" with his wife, the latter acting both individually and as trustee for the children. The agreement provided that the business was to be operated under the same name as before; that

the partnership was to continue for seven years from January 1, 1941; that its capital consisted of the aggregate interest of the parties in a portion of the business assets theretofore owned by taxpayer; and that the interests of the parties were 34% each for taxpayer and his wife, and 32% for the wife as trustee. Taxpayer was to be general manager and receive a salary of $400 per month, while his wife was to be secretary and head bookkeeper and receive a salary of $250 per month. Partnership funds were to be deposited in a partnership bank account, and checks could be drawn only on the signature of taxpayer or, when authorized by him, of the bookkeeper. Expenses were to be paid only on taxpayer's authorization. Profits were to be retained in the business, except such part as should from time to time be distributed by agreement of the parties. (R. 42–44.) The deeds and partnership agreement were recorded, a gift tax return was filed and a gift tax of $145.20 paid, and formation of the partnership was reported to taxpayer's bank and to Dun & Bradstreet. (R. 46, 49.)

The wife and children owned no property other than that which they acquired from taxpayer and contributed as capital to the partnership. (R. 47.) When the deeds of gift and trust were delivered to the wife she understood that the donated assets were to be contributed to the partnership. (R. 45.) In March of 1941 the

business needed operating capital and the partnership agreement was modified to provide for an additional contribution of $10,000 by the wife individually, and of $10,000 by her as trustee. The $20,000 was borrowed from taxpayer's brother, through negotiations of taxpayer, on two unsecured promissory notes signed by the wife individually and as trustee. Taxpayer immediately borrowed this $20,000 from the partnership and used it to pay individual obligations. (R. 47–48.) Partnership funds were later used to repay the $20,000 borrowed from taxpayer's brother. (R. 49.) The wife contributed no capital originating with her, either individually or as trustee. (R. 53.)

After formation of the partnership the business was operated in the same manner as before. Taxpayer placed the business assets to which he had retained title (including timber, lumber, cash and accounts receivable) at the disposal of the partnership. The cash and proceeds of accounts receivable were used in part to defray operating expenses of the business and taxpayer's bills payable as of December 31, 1940, the balance being credited to his account. (R. 46–47.) At the beginning of 1941 taxpayer requested an assistant to set up accounts on the books to reflect the interests of the partners, but no such change was made. (R. 47.) Early in 1942 an accountant, when preparing taxpayer's income tax return for

1941, informed taxpayer that the books did not contain investment or drawing accounts for the wife and trusts. At taxpayer's direction he rewrote the ledger from original journal entries and set up investment accounts for taxpayer, the wife and the trusts. He also reconstructed taxpayer's individual account, which disclosed that at the close of 1941 taxpayer owed the business \$196,037.87. (R. 48–49.)

The wife had no bank account during 1941, either individually or as trustee. She received no funds from the partnership during that year, either for herself or the children, and did not seek to do so. (R. 49.) Nor did she have any authority to draw on the partnership bank account. (R. 50.) She was credited on the books with a \$250 per month salary. (R. 48.)

No vital services were contributed by the wife either individually or as trustee. She had entered taxpayer's employ in 1928 while a high school student on a part-time basis, and her principal duties consisted of making up payrolls and writing invoices. After her marriage to taxpayer (in 1932 (R. 40)) she performed the same kind of clerical work, devoting such time as she was able to spare from her household duties. After the partnership was formed she continued to perform the same services as before except that she "looked at the books more", but she did not supervise the books nor assume responsibility for

any entries. She has but slight knowledge of bookkeeping and does not know enough about the books kept by the partnership to explain any of the transactions reflected. Taxpayer discussed business problems with her occasionally, but managed the business as before and made all the decisions. The wife rendered no services of a managerial nature. (R. 49–50, 53–54.)

The net income of the business for 1941 as disclosed by the partnership return was $188,-786.91, of which $64,187.55 was reported as the distributive share of taxpayer and the balance as the distributive share of the wife individually and as trustee. (R. 50–51.) The income taxes on the amounts allocated to the wife and the trusts were paid by the partnership on their behalf. (R. 49.) The Commissioner determined that the entire net income was taxable to taxpayer. (R. 51.) The Tax Court held that the alleged partnership was not real for federal income tax purposes, and sustained the Commissioner's determination. (R. 52–54.) The Circuit Court of Appeals affirmed. (R. 131.)

ARGUMENT

There is no occasion for further review. This case is controlled by *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, with which the decision below is in accord.

1. The question here is the same as in the *Tower* and *Lusthaus* cases, *supra*. This Court there held that family partnerships erected upon gifts of business capital are without federal income tax significance, though valid under state law, if the arrangement produces no substantial change in the creation of the business income but merely a reallocation of it within the donor's family. And whether the claimed partnership, so tested, has reality presents a question of ultimate fact for the Tax Court, whose conclusion is entitled to finality if supported by substantial evidence. Unless the donee "invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of those things" (*Commissioner* v. *Tower, supra*, p. 290), the Tax Court is justified in concluding that the donee is not a real partner for tax purposes. These principles are not any the less applicable where, as here, the gift is to the wife as trustee for taxpayer's children, as well as to her individually, and the accompanying partnership agreement is executed by the wife in both capacities. Passage of titular ownership of a portion of the business capital to a fiduciary instead of directly to the donee affects the legal form, but not the economic substance, of the arrangement. *Hash* v. *Commissioner,* 152 F. 2d 722 (C. C. A. 4th), certiorari denied, 328 U. S. 879, rehearing

denied, 328 U. S. 838; *Dawson* v. *Commissioner* (C. C. A. 6th), decided September 22, 1947 (1947 C. C. H., par. 9368); *Eisenberg* v. *Commissioner*, 161 F. 2d 506 (C. C. A. 3d), certiorari denied, October 13, 1947; *Losh* v. *Commissioner*, 145 F. 2d 456 (C. C. A. 10th); *Benson* v. *Commissioner*, 161 F. 2d 821 (C. C. A. 5th).

As is plain from its opinion, the Tax Court properly addressed itself to the critical question of who earned the business income. It found that neither individually nor as trustee did the wife contribute capital originating with her, or participate in management, or perform vital additional services (R. 47–50, 53–54); in short, that after formation of the partnership the business was operated "in the same manner as it theretofore had been carried on" by taxpayer as sole proprietor (R. 46). The court below held that these findings were supported by substantial evidence (R. 128, 130), and they are not in dispute (Pet. 12). They amply warrant the conclusion that the wife was not a real partner, either individually or as trustee. Here, as in the *Tower* and *Lusthaus* cases, every ingredient productive of the business income in question—capital, services, and management—emanated from taxpayer.[1] While naked

[1] The wife performed some minor services (R. 49–50, 53), for which she was credited on the books with a salary of $250 per month (R. 48). Her salary was apparently deducted from gross profits in computing the partnership net income allocated among the partners. (R. 50–51.)

legal title to some of the business assets was shifted to the wife individually and as trustee for the children, and specified shares of the net business profits were ascribed to her as a partner, taxpayer continued as before to create the income. The wife became a "partner" in name and on paper only.[2] Under familiar rules governing the scope of judicial review of Tax Court decisions, reiterated by this Court in the *Tower* and *Lusthaus* cases with reference to the very question here presented, affirmance of the Tax Court's decision by the court below was clearly correct.

2. Isolating the gifts from the concurrent partnership agreement, taxpayer alleges conflict with decisions of Circuit Courts of Appeals in cases involving the taxability of trust income to the

---

[2] Not even the usual paper formalities were here fully observed, since investment and drawing accounts were not set up for the wife and trusts until after the taxable year. (R. 48.) Moreover, the income allocated to the wife and trusts was not distributed, but retained in the business; the wife maintained no bank account either individually or as trustee, received no partnership funds, and had no authority to draw any. (R. 49, 50.) Taxpayer thus continued to enjoy control over the income (as well as the corpus) of the partnership interests he purported to give away. The unreality of the arrangement is emphasized by the fact that although the wife and trusts purported originally to contribute 66% of assets valued at $80,000 (R. 43), and later an additional $20,000 (R. 47–48), or a total of about $73,000, the share of net profits ascribed to the wife individually and as trustee for the taxable year amounted to $124,599.36 (R. 51)—a return in a single year of over 170% of her so-called investment.

grantor of the trust. (Pet. 12–13.)[3] With the exception of *Armstrong* v. *Commissioner,* 143 F. 2d 700 (C. C. A. 10th), the cases relied upon are not concerned with family partnerships. Furthermore, the *Armstrong* case was distinguished by the court which decided it in *Losh* v. *Commissioner, supra,* whose factual pattern bears closer resemblance to that of this case; and any remnant of its vitality which may have survived the *Losh* case appears to have been extinguished by the still later decisions of the same court in *Grant* v. *Commissioner,* 150 F. 2d 915 (C. C. A. 10th), and *Bradshaw* v. *Commissioner,* 150 F. 2d 918 (C. C. A. 10th). See also *Earp* v. *Jones,* 131 F. 2d 292 (C. C. A. 10th), certiorari denied, 318 U. S. 764. In any event, whatever conflict in the field of "family partnership" cases existed among (or within) the circuits prior to *Tower* and *Lusthaus* has been authoritatively resolved by this Court's decisions in those cases.

3. Taxpayer's assertion (Pet. 13–14; Br. 25–26) that this case presents an important question which has not yet been settled, insofar as the wife's status as a trustee-partner is con-

---

[3] Even if the case be viewed in this distorted posture, there is no basis for taxpayer's assumption that the Tax Court was obliged to find that he ceased to be the substantial owner of the donated capital. *Helvering* v. *Clifford*, 309 U. S. 331.

cerned, misconceives the rationale of this Court's holdings in the *Tower* and *Lusthaus* cases.[4] The reality of a partnership arrangement predicated upon an intra-family gift obviously does not depend on whether the gift is outright or in trust, conditional or unconditional, or for that matter on what legal mechanics are employed. "By the simple expedient of drawing up papers, single tax earnings cannot be divided into two tax units and surtaxes cannot be thus avoided". *Commissioner* v. *Tower, supra,* p. 291. Unless the donee-partner contributes new capital, or performs vital additional services, or participates in management, there is no change in the creation of the business income and, accordingly, no change in the tax incidence. To permit the tax consequences here to turn upon the considerations stressed by taxpayer would sanction the very type of formalism which this Court in the *Tower* and *Lusthaus* cases refused to recognize as effectual to alter tax liability.

---

[4] Taxpayer's argument (Br. 17–30) is essentially the same as that advanced in support of the petition for certiorari in *Hash* v. *Commissioner*, *supra*, which involved gifts in trust and a partnership agreement with the trustees.

CONCLUSION

The decision below is correct. This case turns upon its facts and presents no question calling for further review. There is no conflict of decisions. The petition should therefore be denied.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
HELEN R. CARLOSS,
HARRY BAUM,
Special Assistants to the Attorney General.

NOVEMBER, 1947.

APPENDIX

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

(26 U. S. C. 1940 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1940 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U. S. C. 1940 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.* — The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1940 ed., Sec. 3797.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

U. S. GOVERNMENT PRINTING OFFICE: 1947